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Cases, Regulations and Statutes

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[4] *See, e.g.*, Rev. Rul. 93-30, I.R.B. 1993-16, 4. See also Ltr. Rul. 8106082, Nov. 18, 1980 (ruling on Wyoming enactment). But see Rev. Rul. 93-38, I.R.B. 1993-21, 4 (limited liability company (LLC) formed under Del. Code tit. 6, §§ 18-101 *et seq*. may be taxed as corporation or partnership because Act allows LLC agreement to provide for centralized management and continuation of company without consent of members after transfer of member's interest).

[5] *See* Va. Code Ann. § 13.1-1008.

[6] Kan. Stat. Ann. §§ 17-7603(a), 17-7604(q).

[7] Utah Code Ann. § 48-2b-104.

[8] Iowa Code § 9H.3A.

[9] *E.g.*, Iowa Code §§ 490A.128, 490A.301.

[10] *E.g.*, Wyo. Stat. § 17-15-107(a)(ii).

[11] *E.g.*, Iowa Code § 490A.1301.

INCOME TAX TREATMENT OF HEDGING

The United States Tax Court has decided a case of substantial importance to the tax treatment of commodity hedges. The issue of the proper handling of hedge transaction gains and losses has been a matter of concern since issuance of a letter by Stuart L. Brown, Associate Chief Counsel (Domestic), IRS, to Henry Bahn, USDA, regarding the Options Pilot Program on January 27, 1993. (See pp. 32 and 80 *supra*.)

In the Tax Court case, the Federal National Mortgage Ass'n had hedged debentures and mortgages with short sales of Treasury securities. Losses were deducted as ordinary losses. I.R.S. objected, citing *Arkansas Best Corp. v. Comm'r, 485 U.S. 212 (1988)*, for the proposition that the gains and losses were properly capital transactions.

The Tax Court held that the FNMA transactions were hedges and that disposition of the hedges resulted in ordinary gains and losses.

The court noted that the transactions were meant to offset the risk of change in interest rates and were, therefore, true hedges. In response to the argument that FNMA had not offset all of its risk, an argument sometimes made with commodity futures transactions, the court said,

> "A taxpayer is not required to negate its entire risk, nor must it hedge every transaction in order to lock in a particular return, since hedges by their very nature are meant to avoid risk of loss (similar to insurance), but not necessarily all risk to which a taxpayer is exposed."

In deciding that the losses on the hedges were ordinary losses rather than capital losses, the court concluded that short positions as well as long positions could reduce price risk and that it was not necessary for ordinary gain and loss treatment for the hedge to be in the same asset that the taxpayers owns or intends to acquire. The court explained that for the hedging position to be eligible for ordinary gain or loss treatment, the hedging transactions must have been integrally related to the purchasing and holding of the assets hedged. In the FNMA case, the court concluded that the hedges bore a close enough relationship to FNMA's mortgages to be excluded from the definition of a capital asset.

Another case is still pending before the Court of Federal Claims, *Cather v. U.S.*, which involves hedging of beef cattle and feed grains, including the use of various options strategies (puts and calls). The FNMA case provides a good deal of assurance that commodity hedges, including short sales, will produce ordinary gain or loss treatment. **Federal Nat'l Mortgage Ass'n, 100 T.C. No. 36 (1993)**.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL

ABSOLUTE PRIORITY RULE. The debtors owned a farm under a sole proprietorship and in their Chapter 11 plan proposed to contribute their labor and exempt property to the farm business to satisfy the absolute priority rule. The debtors' attorney also agreed to be paid out of future farm earnings instead of estate property. The debtors claimed that because the farm business had little or no "going concern" value, the debtors did not retain any interest of value. The court rejected this argument, noting that the U.S. Supreme Court in *In re Ahlers, 485 U.S. 197 (1988)*, held that the retained control over the business and possible future earnings from the business were not sufficient retained interests to invoke the absolute priority rule. The court held that there was no new value exception to the absolute priority rule, but even under such an exception, the debtors' contribution must be necessary for the reorganization and must be substantial and exceed the value of the debtors' retained interests in the business. The debtors were held not to have met the burden of showing their entitlement to the exception. **Unruh v. Rushville State Bank, 987 F.2d 1506 (10th Cir. 1993), *aff'g*, 135 B.R. 410 (D. Kan. 1991), *aff'g*, 108 B.R. 284 (Bankr. D. Kan. 1989)**.

EXEMPTIONS-*ALM* § 13.03[4].*

AVOIDABLE LIENS. The debtor sought to avoid a judgment lien to the extent the lien impaired the debtor's homestead exemption. The judgment was entered to enforce an otherwise unavoidable student loan. The court held that the student loan judgment lien was avoidable to the extent it impaired the homestead exemption. ***In re* Evaul, 152 B.R. 31 (Bankr. W.D. N.Y. 1993)**.

HOMESTEAD. The Bankruptcy Court had ruled that the debtor's entire 32 acre residence was exempt as a rural homestead because Tex. Prop. Code § 41.002(c) defined a homestead as rural if it did not receive municipal utilities or fire or police protection. The District Court reversed and remanded, holding that the statute applied only in foreclosure situations and did not overturn Texas common law which established various factors for determining the

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rural status of a homestead. ***In re* Davis, 152 B.R. 133 (S.D. Tex. 1992)**.

The debtor was allowed a homestead exemption for a semi-truck cab which was equipped with a bunk bed, refrigerator, television, radio, heater and air conditioning but did not have a bathroom or cooking facilities. The debtor had no other residence. ***In re* Laube, 152 B.R. 260 (Bankr. W.D. Wis. 1993)**.

STATE OPT-OUT PROVISION. The Arkansas legislature repealed the Arkansas opt-out provision to allow debtors to choose either the state or federal exemptions. A creditor objected to the debtor's use of the federal exemptions, arguing that the repeal was an adoption of the federal exemptions as state law and the federal exemption for insurance proceeds violated the state constitution limit on personal exemptions. The court held that the opt-out election was revocable and that the repeal of the opt-out election did not effect an adoption of the federal exemptions as state law but merely reinstated the federal rule for choice of state or federal exemptions by the debtor unless a state has opted-out of the federal exemptions. ***In re* Criswell, 152 B.R. 264 (Bankr. E.D. Ark. 1992)**.

WILD CARD. The debtor sought to claim a one-third remainder interest in a farm as exempt under the Illinois "wild card" exemption. The court held that the "wild card" exemption could not be used to exempt real property. **In re Woodworth, 152 B.R. 258 (Bankr. C.D. Ill. 1993)**.

CHAPTER 12

ADMINISTRATIVE EXPENSES. After the Chapter 12 debtors sought discharge after completion of the plan, a creditor sought discovery and review of the debtors' records to determine whether all disposable income was paid. As a result of this effort, an additional $19,000 was paid to the trustee for distribution to unsecured creditors. The creditor petitioned for recovery of its expenses, over $17,000, in pursuing the recovery of these funds. The trustee argued that because the creditor had not sought prior court approval for its actions and because such recovery was not allowed in Chapter 12 cases, under Sections 503(b)(3)(B) and 503(b)(3)(D), the creditor should not be entitled to recover the costs. The court held that the fees were not recoverable in a Chapter 12 case. ***In re* Peterson, 152 B.R. 612 (D. S.D. 1993), *rev'g*, 145 B.R. 631 (Bankr. D. S.D. 1992)**.

AUTOMATIC STAY. Prior to the filing of the bankruptcy case, the creditor filed for foreclosure of a mortgage on the debtor's farm and the foreclosure judgment was entered by default after the debtor failed to appear. The foreclosure documents were sent to the wrong post office box but the debtor received personal service of court documents. The final default judgment notice also stated that the date of judgment would be July 6 but the hearing was actually held July 20, although the debtor appeared on neither date. The creditor sought relief from the automatic stay to complete the foreclosure process and the debtor resisted, arguing that the judgment should have been set aside because of the irregularities. The court held that because the foreclosure judgment was entered pre-petition with only harmless irregularities, the mortgage relationship was dissolved and the creditor would be granted relief from the automatic stay. ***In re* Berg, 152 B.R. 289 (Bankr. D. S.D. 1993)**.

CHAPTER 13

ELIGIBILITY-*ALM* § 13.03.* The debtor had a $106,000 unsecured claim filed by the IRS and the trustee objected to the Chapter 13 plan because the debtor's unsecured claims exceeded the $100,000 eligibility amount for Chapter 13. The debtor argued that the claims, resulting from Tax Court judgments, were partly unliquidated penalties which should not have been allowed as claims in the bankruptcy case. The court held that the Bankruptcy Court had no authority to question the Tax Court judgments and dismissed the case. **Matter of Hammers, 998 F.2d 32 (5th Cir. 1993)**.

FEDERAL TAXATION

ALLOCATION OF PLAN PAYMENTS FOR TAXES. The debtor's Chapter 11 plan provided for payments on its employment tax claims first to the trust fund portion of the claims before payment of interest and penalties. The debtor argued that the allocation was necessary for a successful reorganization because if the corporate officers remained liable for the trust fund taxes, the officers would not continue to seek reorganization of the corporation. The court held that the allocation was necessary for a successful reorganization and would be allowed. ***In re* R.L. Himes & Assoc., Inc., 152 B.R. 198 (S.D. Ohio 1993)**.

The debtor sought an amendment to the Chapter 13 plan to provide that payments to the IRS be allocated first to the debtor's income tax liability and then to the debtor's employment tax liability. The debtor argued that the allocation would benefit everyone involved because the allocation would result in a third party paying more of the employment taxes and making all payments faster. The court held that the plan could be so amended. ***In re* Klaska, 152 B.R. 248 (Bankr. C.D. Ill. 1993)**.

CLAIMS. The debtor objected to the IRS claim for taxes, claiming that an amended return was filed in 1989 which lowered the taxes for 1984 by electing income averaging. The debtor had no proof of mailing and the amended returns were sent by ordinary mail. The debtor argued that the court had discretion under Section 505 to determine the 1984 taxes by allowing the income averaging election. The court declined to exercise the discretionary authority because (1) the only claims were secured claims and the unsecured tax claims and (2) the judgment sought by the debtor would only benefit the debtor and not any unsecured creditors. ***In re* Swan, 152 B.R. 28 (Bankr. W.D. N.Y. 1992)**.

DISCHARGE-*ALM* § 13.03[6].* In 1981, the debtor had filed a W-4 form listing 40 exemptions. In 1987, the debtor filed returns for 1982 through 1985 claiming three exemptions. The debtor filed bankruptcy more than three years after the returns were filed and claimed the taxes owed as dischargeable. The IRS argued that the taxes were not dischargeable because the false W-4 form, the late filed returns and the filing of bankruptcy just after the taxes became dischargeable were an attempt to evade taxes. The Bankruptcy Court granted summary judgment for the debtor, holding that the circumstances did not prove a willful attempt to evade taxes and that the taxes were dischargeable. The District Court reversed and remanded, holding that the debtor's actions left questions of fact as to a willful attempt to evade taxes. ***In re* Peterson, 152 B.R. 329 (D. Wyo.**

1993), ***rev'g and rem'g*****, 132 B.R. 68 (Bankr. D. Wyo. 1991)**.

The debtor had failed to file accurate income tax returns for several years in an attempt to recover losses incurred from an erroneous but uncompensable government seizure of the debtor's business assets. In defending the actions in the Tax Court, the debtor argued that the tax returns were improperly filed because of a mental illness resulting from the belief that the government was persecuting the debtor. The Tax Court rejected the mental illness defense and held that the debtor willfully failed to file the proper returns. The Bankruptcy Court held that the Tax Court decision was *res judicata* on the issue of willfulness; therefore, the tax liability resulting from the improper returns was nondischargeable. ***In re*** **Lilley, 152 B.R. 715 (Bankr. E.D. Pa. 1993)**.

NET OPERATING LOSSES. The debtor made the election to carry forward net operating losses on pre-bankruptcy and post-bankruptcy income tax returns. The appellate court held that the bankruptcy trustee could avoid the election so that the trustee could carry back the NOL for refunds. On remand, the Bankruptcy court held that the prepetition NOL election was not made with intent to defraud creditors because the debtor relied on the advice of accountants in making the election solely for tax planning purposes. The court also held that the post-petition NOL election was not improper because such an election is a normal business decision. ***In re*** **Russell, 93-1 U.S. Tax Cas. (CCH) ¶ 50,309 (W.D. Ark. 1993)**, ***on rem. from*****, 927 F.2d 413 (8th Cir. 1991)**.

PENALTIES. The debtor was assessed for post-petition federal employment and unemployment taxes and was assessed interest and penalties. The debtor argued that the interest and penalties on the taxes which were not required to be withheld were discharged by the bankruptcy case. The court held that all interest and penalties were not discharged. ***In re*** **Paulson, 152 B.R. 46 (Bankr. W.D. Pa. 1993)**.

TAX LIENS. The court held that the debtor's vested interest in a pension plan was property to which a tax lien could attach. ***In re*** **Raihl, 152 B.R. 615 (Bankr. 9th Cir. 1993)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION-*ALM* § 5.04[4].* The decedent's will provided authority for the executor to make distributions from the estate to persons who contributed to the decedent's care during life. The remainder of the estate was to pass to two named charitable organizations. The court held that the estate was not allowed a charitable deduction for the amounts which actually passed to the organizations because the amount of the charitable gifts was not ascertainable at the decedent's death since the executor had unlimited authority to make distributions to persons who cared for the decedent. **Est. of Marine v. Comm'r, 990 F.2d 136 (4th Cir. 1993)**, ***aff'g*****, 97 T.C. 368 (1991)**.

The taxpayer donated wooded lakefront property to a tax-exempt organization which was required by the transfer agreement to conserve the property in its natural state for public recreation. The transfer agreement reserved for the taxpayer an interest in subsurface oil, gas and mineral rights but restricted extraction to that which would cause only temporary, localized impact on the property. The IRS ruled that the transfer was a qualified conservation contribution eligible for the gift tax charitable contribution deduction. **Ltr. Rul. 9318027, Feb. 5, 1993**.

CLAIMS AGAINST ESTATE. The decedent made several gifts of money to the decedent's children who transferred the money back to the decedent in exchange for a non-interest bearing note payable in 25 years or upon the death of the decedent. The decedent reported the gifts on federal gift tax returns. The court held that the estate could not deduct the notes as claims against the estate because the notes did not represent bona fide debts contracted for full and adequate consideration. **Est. of Flandreau v. Comm'r, 93-1 U.S. Tax Cas. (CCH) (2d Cir. 1993)**, ***aff'g*****, T.C. Memo. 1992-173**.

DEDUCTIONS-*ALM* § 5.04.* The decedent was the sole shareholder of a corporation which leased real property from an unrelated third party. The decedent had personally guaranteed the rent for the corporation to the extent of $75,000 for 1991. After the decedent died, the corporation ceased operations and defaulted on the 1991 rent and the landlord filed a claim against the estate for $75,000 on the guarantee. The IRS ruled that the estate could deduct the post-death payment of the $75,000 because the claim was contingent at the date of death. **Ltr. Rul. 9321004, Feb. 16, 1993**.

GENERATION SKIPPING TRANSFER TAX-*ALM* § 5.04[6].* Under one trust agreement, two trusts were formed one each for the grantor's children. All parties to the trusts agreed to change the situs of the trusts to another state and to substitute a corporate trustee. The parties also agreed to amend the trust to allow the grantor to acquire trust assets in exchange for assets of equal value. The IRS ruled that the change of situs and trustee did not subject the trusts to GSTT. The IRS refused to rule on whether the amendment to the trust would cause the trust corpus or income to be included in the grantor's gross estate. **Ltr. Rul. 9318019, Feb. 4, 1993**.

GROSS ESTATE-*ALM* § 5.02.* The decedent's estate included property in which the decedent had received a life interest from the estate of the decedent's predeceased spouse and for which the predeceased spouse's estate had claimed as QTIP. The decedent's estate excluded the QTIP property, arguing that the property was not eligible QTIP because the trustee had discretion as to how often to make distributions. The court found that the trust required reasonable distributions, which the court interpreted as at least quarterly. The court also held that the estate was improperly attempting to revoke the irrevocable QTIP election. **Est. of Cavenaugh v. Comm'r, 100 T.C. No. 27 (1993)**.

INCOME IN RESPECT OF DECEDENT. the taxpayer established a revocable trust with the taxpayer as beneficiary. The trust corpus consisted of corporate stock and the grantor entered into an agreement with the trustees to borrow additional stock from the corporation and to place an order for a short sale of the stock. The short sale was entered into as a protection against loss of trust corpus from devaluation of the stock. The IRS ruled that if the taxpayer dies before the short sale is closed, any income resulting from the short sale would not be income in respect of

Agricultural Law Manual* (ALM). For information about ordering the *Manual*, see the last page of Vol 4, No. 11* decedent and the basis of the stock would equal its fair market value. **Ltr. Rul. 9319005, Feb. 4, 1993.

The decedent's estate included the decedent's interest in a profit sharing plan which provided for distribution of payments to the surviving spouse with a contingent remainder to the children. The surviving spouse filed a timely qualified disclaimer of 44.3 percent of the profit sharing plan, which passed to the children under the plan provisions. The IRS ruled that the post-death income was income in respect of decedent and that the surviving spouse's disclaimer of the 44.3 percent interest was effective to pass the tax liability for the income to the children. **Ltr. Rul. 9319029, Feb. 12, 1993**.

MARITAL DEDUCTION-*ALM* § 5.04[3].* The decedent's 1978 will bequeathed an amount of the estate to a marital trust equal to the "maximum allowable marital deduction." The decedent died in 1983 without changing the will. In 1987, Tennessee passed a statute allowing such bequests to qualify for the unlimited marital deduction if a state probate court determined that to be the intention of the decedent. The court held that the statute was insufficient to qualify the bequest for the unlimited marital deduction because the statute itself did not construe the bequest, but allowed a court to do the construing. **Hall v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 60,135 (M.D. Tenn. 1993)**.

The decedent's will bequeathed the entire estate to the surviving spouse and directed that the estate taxes be paid from the estate residue or other available funds. The executor paid the taxes only from an intervivos trust established by the decedent, claiming that the Ohio apportionment statute required such payment. The court held that because the decedent's will directed payment of the taxes from the estate, the executor's apportionment of the taxes entirely to the trust was improper; therefore the amount of the marital deduction should have been reduced by the estate's portion of the taxes. **Est. of Swallen v. Comm'r, T.C. Memo. 1993-149**.

The decedent's estate included stock which passed to a trust for the surviving spouse qualifying as QTIP. The estate sold the stock to the corporation's ESOP and claimed a deduction under I.R.C. § 2057 (repealed in 1988). The court held that the estate could not claim a deduction for the stock sale to the extent that the value of the stock was already used for the marital deduction. **Est. of Reeves v. Comm'r, 100 T.C. No. 28 (1993)**.

The taxpayer established a trust for the taxpayer's resident alien spouse which was revocable until the taxpayer's death. The trust was a qualified domestic trust and was to be funded with the remainder interest in the taxpayer's IRA. The trust provided that the annual distributions to the surviving spouse must equal the greater of the income attributable from the IRA or the IRA balance divided by the life expectancy of the surviving spouse. The IRS ruled that the trust must be irrevocable as of the taxpayer's required beginning date in order for the taxpayer to elect to have the minimum required distribution from the IRA determined by and distributed over a period not to exceed the joint life expectancy of the taxpayer and surviving spouse. The IRS also ruled that the surviving spouse's interest in the trust was eligible for the marital deduction but the surviving spouse could not elect to have the IRA treated as owned by the spouse. **Ltr. Rul. 9321032, Feb. 24, 1993**.

The taxpayer established an intervivos irrevocable trust for the taxpayer's spouse which would be funded at the taxpayer's death with the taxpayer's IRA. The trust provided that the annual distributions to the surviving spouse must equal the greater of the income from the IRA or the IRA balance divided by the life expectancy of the surviving spouse. The IRS ruled that the trust would be QTIP eligible for the marital deduction. **Ltr. Rul. 9321035, Feb. 24, 1993**.

POWER OF APPOINTMENT. At the decedent's death, the decedent was trustee and beneficiary of a trust established by the decedent's predeceased spouse. The decedent had the power as trustee to distribute trust corpus to the decedent or the decedent's children for their "support, comfort, happiness and welfare." The IRS ruled that the trust corpus was included in the decedent's gross estate because the decedent held a general power of appointment over the trust corpus not subject to an ascertainable standard. **Ltr. Rul. 9318002, Jan. 15, 1993**.

The decedent had received property under a predeceased spouse's will in 1938. The will provided that the decedent could use the property free of accountability but provided for passing of the property to the children at the decedent's death. A bank had been appointed conservator of one of the children and the bank filed a disclaimer of that child's interest in the decedent's residuary bequest. The IRS ruled that the decedent had a general power of appointment over the property received from the predeceased spouse, and because the interest was created prior to 1942, the property would not be included in the decedent's estate unless the decedent exercised the power by will or otherwise disposed of the property as if the property was owned by the decedent. The IRS also ruled that the disclaimer was effective. **Ltr. Rul. 9318020, Feb. 4, 1993**.

TRANSFERS WITHIN THREE YEARS OF DEATH-*ALM* § 5.02[2].* The decedent had created a revocable trust with the decedent as sole beneficiary. The trustee was directed to make distributions of income and corpus to the decedent "or otherwise" as the decedent directed. The decedent made written requests to the trustee for "gifts" to third persons within three years of death. The IRS ruled that the transfers were includible in the decedent's gross estate. **Ltr. Rul. 9318004, Jan. 22, 1993**.

TRUSTS-*ALM* § Ch. 8.* The decedent was a remainder beneficiary of a trust established by a predeceased parent. The trust provided that the trust passed to the decedent "or her heirs per stirpes" at the death of the parent. The trustee decided to distribute the decedent's share of the trust in ten annual payments. The decedent's estate argued that the decedent's interest in the trust was a life estate and any remaining trust corpus would not be included in the decedent's estate. The court held that the trust corpus was includible in the decedent's gross estate and that the trustee's method of distribution did not make the interest a life estate. **Stack v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 60,136 (D. Minn. 1993)**.

The decedent's will created a seven-year trust with equal shares for five heirs. The trust provided that if a beneficiary died before the trust terminated, one half of that beneficiary's share passed to that heir's surviving spouse and one-half passed to that heir's heirs. One beneficiary predeceased the decedent and that share was split between a surviving spouse and child. After the trust terminates, 75 percent of the trust corpus passed to the beneficiaries and 25 percent passed to 17 other heirs or their heirs. The IRS ruled that the six current beneficiaries' shares and the 25 percent remainder share could be treated as separate trusts. **Ltr. Rul. 9321034, Feb. 24, 1993**.

VALUATION-*ALM* § 5.02[3][a].* The court accepted the estate's valuation of the decedent's interests in oil and gas mineral properties because the valuation accounted for several factors which a potential buyer would consider. The IRS valuation method of using the average of the past three year's income was rejected as too simplistic. **Est. of Smith v. Comm'r, T.C. Memo. 1993-236**.

The decedent, a sole shareholder of a corporation, entered into an agreement with the corporation to redeem 50 of 52 shares for a promissory note for $700,000. This transaction had a significant impact on the corporation's earnings and cash value. Concurrent with the agreement, the decedent transferred two shares to a son and his spouse for $26,000. The IRS argued that the son's purchase of the stock was a gift because the company was worth $800,000 on the date of the transfer. The court held that the redemption agreement reduced the value of the company to $500,000 and the cost of the redemption agreement, $700,000, reduced the company to insolvency and made the son's purchase price of the stock more than the stock's value; therefore, no gift occurred. **Est. of Bruce v. Comm'r, T.C. Memo. 1993-244**.

The taxpayer owned 47 percent of the common stock of a rural electric company with 3 percent of the stock owned by the taxpayer's children and 50 percent owned by a trust of which the taxpayer was the sole beneficiary with limited right to corpus distribution. The taxpayer recapitalized the company, issuing one share of common and one share of preferred stock for each existing share. The preferred stock would have a dividend of 8 percent but no voting, liquidation, put, call or conversion rights. The IRS ruled that the value of each class of stock would be determined by subtracting the value of all family-held senior equity interests from the market value of all family-held interests in the entity and allocating the remaining value to the subordinate family-held equity interests. **Ltr. Rul. 9321046, Feb. 25, 1993**.

CORRECTION. On p. 82 *supra*, Ltr. Rul. 9315019, Jan 13, 1993 should be Ltr. Rul. 9315010, Jan. 13, 1993.

FEDERAL INCOME TAXATION

COOPERATIVES-*ALM* § 14.03.* A nonexempt cooperative which manufactured and distributed fertilizer for its patrons had interest income from investment of cash in money market instruments having a maturity of 30 days or less and instruments with maturity over 30 days. The District Court held that the interest from instruments with maturities of 30 days or less was patronage sourced income but that the instruments with longer maturity were not because the cooperative had no business purpose for the longer term investments. The appellate court modified the holding by also allowing the interest from longer notes as patronage sourced income because the longer notes were also part of the cooperative's money management process. **CF Industries, Inc. v. Comm'r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,313 (7th Cir. 1993), *aff'g and modifying*, T.C. Memo. 1991-568**.

DEPRECIATION-*ALM* § 4.03[4] A corporation purchased an estate for years in farmland and the shareholders purchased the remainder interests. The court held that the corporation's interest was amortizable because the separate interests were purchased with separate funds. **Richard Hansen Land, Inc. v. Comm'r, T.C. Memo. 1993-248**.

FAMILY ESTATE TRUSTS-*ALM* § 8.08.*. The taxpayers transferred a veterinary practice and cattle business to a trust with the taxpayer and spouse as beneficiaries and trustees. The court held that the trust had no economic substance and all trust income was chargeable to the taxpayers, where the taxpayer retained control over all assets and performed no trustee duties. **Paulson v. Comm'r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,271 (8th Cir. 1993), *aff'g*, T.C. Memo. 1991-508**.

FUTURES CONTRACTS. The taxpayer invested in commodity futures contracts and challenged the constitutionality of I.R.C. § 1256 which required recognition of taxable gain on the contracts which were held at the end of the taxable year, even though the contracts had not been sold. The court upheld the constitutionality of the statute because the taxpayer could receive the gain on the marked-to-market contracts at any time. **Murphy v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,270 (9th Cir. 1993)**.

HOME OFFICE EXPENSE-*ALM* § 4.03[13].* An art teacher was denied deductions for home office related expenses for a home art studio because the principal place of business was the school where the taxpayer was employed and the home studio was not maintained for the employer's convenience. In addition, the taxpayer could not deduct the cost of art supplies because the sale of the art was not sought in a reasonable, commercial manner. **Bowles v. Comm'r, T.C. Memo. 1993-222**.

INTEREST RATE. The IRS has announced that for the period July 1, 1993 through September 30, 1993, the interest rate paid on tax overpayments remains at 6 percent and for underpayments remains at 7 percent. The interest rate for underpayments by large corporations remains at 9 percent. **Rev. Rul. 93-40, I.R.B. 1993-23**.

INVESTMENT TAX CREDIT-*ALM* § 4.04.* The taxpayers purchased a certified historic building in 1982 and developed a 60 month plan for complete rehabilitation of the building. The building had a basis of $2 million and the 1982 rehabilitation expenditures were $500,000 for which the taxpayers claimed investment tax credit. The court held that because the expenditures in 1982 had not yet exceeded the building's basis, the ITC was not allowed in 1982. The court noted that the ITC would be available in the taxable year of the completion of the 60 month plan and any excess ITC could be carried back. **Ford v. U.S., 93-1 U.S. Tax Cas. (CCH) ¶ 50,268 (11th Cir. 1993)**.

PARTNERSHIPS-*ALM* § 7.03.*

DISTRIBUTIONS. The general partners of a limited partnership were considered to have received distributions from the partnership to the extent the partnership funds were used to pay for a new home for the partners which was not transferred to the partnership **White v. Comm'r, 93-1 U.S. Tax Cas. (CCH) ¶ 50,273 (10th Cir. 1993), *aff'g*, T.C. Memo. 1991-552**.

LIMITED LIABILITY COMPANY. The IRS has ruled that a limited liability company (LLC) formed under the Delaware Limited Liability Company Act, Del. Code tit. 6, §§ 18-101 *et seq*., may be taxed as a corporation or a partnership because the Act allows the LLC agreement to provide for centralized management and continuation of the company without consent of the members after the transfer of a member's interest. Thus, if the LLC agreement does not provide for these occurrences, the LLC may be taxed as a partnership. **Rev. Rul. 93-38, I.R.B. 1993-21, 4**.

RETIREMENT PLANS. The U.S. Supreme Court has ruled that the contribution by an employer of unencumbered real property to a defined benefit pension plan in satisfaction of the employer's minimum funding obligation is a prohibited transaction under I.R.C. § 4975(c)(1)(A). **Commissioner v. Keystone Consolidated Indus., Inc., 93-1 U.S. Tax Cas. (CCH) ¶ 50,298 (S. Ct. 1993), *rev'g*, 951 F.2d 76 (5th Cir. 1992)**.

S CORPORATIONS-*ALM* § 7.02[3][c].*

ONE CLASS OF STOCK. An S corporation entered into a split dollar life insurance agreement under which the corporation would pay the premiums on a life insurance policy on the life of a shareholder with the shareholder reimbursing the corporation to the extent the premium conferred an economic benefit on the shareholder. The IRS ruled that the agreement did not created a second class of stock **Ltr. Rul. 9318007, Jan. 29, 1993**.

TERMINATION. The IRS waived as inadvertent the termination of an S corporation's election where the corporation's accountant failed to pay the Section 1375 tax resulting from three years of passive investment income in excess of 25 percent of gross receipts. **Ltr. Rul. 9318006, Jan. 25, 1993**.

SALE OR EXCHANGE. The decedent bequeathed a residence to two surviving children as tenants in common. The children divided the property with each taking a fee interest in one-half of the property. The IRS ruled that the division of the property was not a sale or exchange subject to taxable gain under I.R.C. § 1001(a) or (c). **Ltr. Rul. 9319032, Feb. 12, 1993**.

SAFE HARBOR INTEREST RATES
June 1993

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 3.62	3.59	3.57	3.56	
110% AFR	3.99	3.95	3.93	3.92
120% AFR	4.36	4.31	4.29	4.27
		Mid-term		
AFR 5.33	5.26	5.23	5.20	
110% AFR	5.87	5.79	5.75	5.72
120% AFR	6.41	6.31	6.26	6.23
		Long-term		
AFR 6.47	6.37	6.32	6.29	
110% AFR	7.13	7.01	6.95	6.91
120% AFR	7.79	7.64	7.57	7.52

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(current issue items in **bold**)